DOCUMENT RESUME

ED 257 347 HE 018 376

AUTHOR	Hyatt, James A.; Santiago, Aurora A.
TITLE	Incentives and Disincentives for Effective Management.
INSTITUTION	National Association of Coll. and Univ. Business Officers, Washington, D.C.
SPONS AGENCY	Fund for the Improvement of Postsecondary Education (ED), Washington, DC.
REPORT NO	ISBN-0-915164-24-8
PUB DATE	84
NOTE	66p.; Part of a larger study on initiating improvements and cost savings in public colleges and universities, which was conducted jointly with the Education Commission of the States and the Institute of Policy Studies at Vanderbilt University.
AVAILABLE FROM	National Association of College and University Business Officers, One Dupont Circle, Suite 500, Washington, DC 20036-1178 ($15.00).
PUB TYPE	Guides - Non-Classroom Use (055)
EDRS PRICE	MF01 Plus Postage. PC Not Available from EDRS.
DESCRIPTORS	*Budgeting; Case Studies; *Change Strategies; *College Administration; *Cost Effectiveness; *Financial Policy; Government School Relationship; Higher Education; Incentives; *Money Management; Resource Allocation; State Boards of Education; State Colleges
IDENTIFIERS	Connecticut; Kentucky; Maryland; Massachusetts; *Public Colleges; University of Connecticut; Washington

ABSTRACT

Experiences of five states that have created incentives for the effective management of higher education or that have eliminated disincentives are examined. After considering the effect of state budgetary controls and regulations on college operations, methods used to determine levels of state support and to allocate state funds are addressed. In Idaho, a change was made to a lump-sum, single appropriation to the Board of Regents/Trustees, which then allocated a lump sum to each college. Kentucky's colleges were provided flexibility in business management by providing for changes in purchasing, capital construction, real estate acquisition and sale, accounting/auditing, and payroll operation. Changes in Maryland included: allowing colleges to transfer funds and positions within specified limits, carryover special and federal funds, and credit interest income to the institution. The creation of a tuition fund at the University of Connecticut has provided the school flexibility in the administration of local funds. In Massachusetts, the Board of Regents now submits a unitary budget request for higher education, rather than individual budgets for each campus. Changes in the budgetary process in Washington and Kentucky are also identified. State college and university contact persons are identified. (SW)

ED257347

NACUBO

Incentives and Disincentives For Effective Management

James A. Hyatt
Aurora A. Santiago

HE018 306

"PERMISSION TO REPRODUCE THIS MATERIAL IN MICROFICHE ONLY HAS BEEN GRANTED BY

NACUBO

TO THE EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)."

U.S. DEPARTMENT OF EDUCATION
NATIONAL INSTITUTE OF EDUCATION
EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)

✓ This document has been reproduced as received from the person or organization originating it.
Minor changes have been made to improve reproduction quality.

• Points of view or opinions stated in this document do not necessarily represent official NIE position or policy.

©1984 by the National Association of
College and University Business Officers
One Dupont Circle, Suite 500
Washington, D.C. 20036-1178

Printed in the United States of America

ISBN 0-915164-24-8

Library of Congress Catalog Card Number: 84-62445

Contents

Foreword

Acknowledgments

Overview 1

Appropriation Controls: Idaho 9

Regulatory Disincentives: Kentucky 16

Incentives to Management Flexibility Through Deregulation: Maryland 24

Administration of Local Revenues: Connecticut and Idaho 36

The Budgetary Process: Massachusetts, Washington, and Kentucky 43

The views expressed in both the ECS resource catalog and in this NACUBO monograph do not reflect endorsement by FIPSE.

Foreword

Colleges and universities face a markedly different environment today than they did in the past. Uncertain enrollment levels and limited fiscal resources, already major constraints for a number of public institutions, at times are compounded by stringent state controls and regulations that further hamper an institution's ability to respond effectively to problems.

To address this issue, the Education Commission of the States, NACUBO, and the Institute for Public Policy Studies at Vanderbilt University, under a grant from the Fund for the Improvement of Postsecondary Education (FIPSE), conducted a study on initiating improvements and cost savings in public colleges and universities. As its part of the study, NACUBO focused specifically on how state budgetary and regulatory procedures can be modified to give institutions the flexibility to respond appropriately to the challenge of maintaining quality even when faced with a declining financial base. (The complete study, titled *Quality and Flexibility in Higher Education: A Resource Catalog of Innovative State Fiscal Practices*, will be available when published from the Education Commission of the States, Suite 300, 1860 Lincoln Street, Denver, Colorado 80295.)

Case studies on six states are presented and include both state and institutional perspectives. Although the case studies deal only with public institutions, other colleges and universities may find it useful to consider how the budgetary process can serve as a vehicle for institutional flexibility and increased management effectiveness rather than as an obstacle to them.

We appreciate the cooperation of the institutions and the state officials who participated in the study.

Robert L. Carr
Executive Vice President

Acknowledgments

Assistance for this project was provided by the ECS Advisory Group and the joint ECS/Vanderbilt Advisory Group. Members of the ECS Advisory Group were Richard Allen, Colorado Commission on Higher Education; James Browne, U.S.A. Publishing Foundation for Education Research; A. W. Flowers, Maricopa County Community College Systems Office; Robert Dickeson, University of Northern Colorado; Arthur L. Gillis, Brandeis University; Paul Lingenfelter, Illinois Board of Higher Education; Marilyn McCoy, University of Colorado; Mark Sullivan, Connecticut Board of Higher Education; and Robert K. Thompson, University of Washington. Members of the joint ECS/Vanderbilt Advisory Group were: Richard D. Wagner, Illinois Board of Higher Education; David J. Berg, University of Minnesota; Lyman Glenny, professor emeritus, University of California-Berkeley; Robert Lang, Wisconsin Legislative Fiscal Office; Jerry Miller, National Association of State Budget Officers; and Adrian Tinsley, Minnesota State University System.

General oversight in the preparation of this monograph was provided by members of NACUBO's Financial Management Committee: A. W. Flowers (Chairman), Maricopa County Community College Systems Office; David J. Berg, University of Minnesota; Jack C. Blanton, University of Kentucky; James Grant, SUNY College at New Paltz; Robert E. Kirkpatrick, New Mexico State University; Burton Sonenstein, Wesleyan University; George L. Worsley, North Carolina State University; and Dennis Jones (ex-officio), National Center for Higher Education Management Systems.

The field review edition of the monograph was sent to a number of college and university business officers and other knowledgeable persons. NACUBO would like to express appreciation to the reviewers, whose comments were helpful in revising the study.

Overview

During periods of fiscal stress, colleges and universities are frequently forced to make major programmatic and administrative decisions under severe time and political pressures. The ability of public institutions to respond effectively to funding reductions or to improve management processes is often hampered by state controls and regulations. Recently, administrators at public institutions have requested increased flexibility so they can respond effectively to challenges. State executives, legislators, and agency staff, however, are often unsure of the benefits of permitting institutions more autonomy, and they are apprehensive over the prospect of decreased accountability to the state.

The purpose of this monograph is to examine the experience of several states that have created incentives for the effective management of higher education or that have eliminated disincentives. First, the effect of state budgetary controls and regulations on institutional operations is examined. Second, methods used to determine levels of state support and to allocate state funds are addressed.

Effect of State Budgetary Controls and Regulations

State governments and public colleges and universities share two common goals. The first is the establishment and maintenance of high-quality academic and support programs that meet diverse state needs for instruction, research, and public service. The second is the effective provision of these services. Proponents of strong central control of higher education argue that these goals can best be achieved through detailed budgetary and accounting procedures or through comprehensive state regulation of institutional operations.

2

Proponents of institutional flexibility argue that controls and regulations often hinder the efficient use of resources.

Frequently cited examples of restrictive state controls and regulations include:

1. Restrictions of institutional authority to reallocate funds among expenditure categories during the fiscal year.
2. Cumbersome state regulations governing institutional operations such as purchasing, personnel, and capital construction.
3. Regulations concerning retention and management of local revenues such as tuition and fees.
4. Reversion of unexpended fund balances.
5. Pre-audits of institutional operations.

Illustrations of how the centralized controls noted above can hamper institutional flexibility are presented below.

1. ***Restrictions of authority to reallocate funds.*** Institutions confronted with revenue reductions need the flexibility to move funds among various units in order to avoid major dislocations in programs and services. In Idaho the state legislature has changed the appropriation process for institutions governed by the Idaho Board of Regents/Trustees from a detailed line-item appropriation by number of full-time-equivalent (FTE) positions and standard expenditures class (such as personnel service, operating expense, and capital outlay) to a lump-sum appropriation. According to administrators at the University of Idaho, these changes have allowed the institution flexibility to evaluate alternatives for improving operations and helped it respond to major reductions in state support.

Similar changes have occurred in various other states. Flexibility granted public institutions in Colorado, for example, has enabled the University of Colorado to reallocate funds, meet high-priority needs, and respond to

revenue shortfalls. In North Dakota, there are three main divisions in the budget: salaries and wages; operating expenses; and equipment. Institutions are now permitted to shift funds from one division category to another. Increased flexibility in transferring funds among budget line items and reductions in the number of line items have also occurred in Connecticut, Massachusetts, and Maryland.

2. ***Cumbersome regulations.*** Detailed state regulations and central control of functions like purchasing and capital construction can also impair institutional flexibility. Before HB 622 passed in Kentucky, for example, all procurement for higher education, including capital construction, was directed and controlled by state government. Costly administrative structures on each campus had "pushing paper" through the state bureaucracy as their primary responsibility. HB 622 (which is discussed in greater detail later in the monograph) now allows public institutions to determine the best value for their money. With responsibility for its own purchasing, the University of Kentucky estimates that it will save approximately $500,000 per year. The university estimates saving approximately $995,000 in capital construction as a result of shortening the procurement process. The University of Wisconsin System also improved efficiency when it was given the authority for general purchasing, printing, computer acquisitions, telecommunications, and employee classifications.[1]

3. ***Management of local revenues.*** Allowing institutions greater flexibility in managing local revenues can also save money. In 1981, for example, an experimental fund

[1] *Management Flexibility and State Regulation in Higher Education*, a Southern Regional Education Board Study edited by James A. Mingle (1983)

established at the University of Connecticut gave the university authority to set its own tuition rates and to retain tuition revenue. The main benefits the university expects from the fund are: (1) interest income from tuition revenue; (2) exemption of tuition revenue from rescissions of general fund appropriations; (3) potential additional revenue from higher tuition; and (4) autonomy regarding the expenditure of tuition funds. The ability to control this source of local revenue has given the university a certain degree of fiscal stability and autonomy.

As noted in another section, each governing board in Colorado has been granted authority to set tuition policy (within general state guidelines) and to retain, expend, or roll forward all cash revenues generated within its institution. The effect has been a noticeable increase in the revenues generated by tuition and an additional $300,000-$500,000 in interest income per annum, depending on interest rate levels, from accelerated tuition collections. The selective management of tuition structures at the general campuses of the University of Colorado has provided the lowest average rates of increase for full-time resident undergraduates among the state's public universities. Specifically, the university has mitigated the impact of tuition increases on resident undergraduate students through the use of larger-than-average differential tuition increases for nonresident undergraduates, graduate students, and students in professional schools.

4. ***Reversion of unexpended fund balances.*** In some states, such as Maryland and North Carolina, state funds not expended by the end of the fiscal year revert to the state treasury. As a result, institutions tend to expend or encumber all state funds before the close of the fiscal year. Such expenditures often do not reflect the best use of state resources.

5

The management of local revenues by the University of Idaho illustrates the advantages of permitting institutions to retain unexpended funds. All state tax revenue funds not expended by the end of the fiscal year revert to the state treasury in Idaho. This is not the case for local funds, that is, income from student fees, land grant endowment, and revenue from sales and services. These funds are not deposited in the state treasury and are managed entirely by the university. The result has been a significant reduction in year-end purchases, and the carrying forward of small balances has partially compensated for budget reductions. In some instances, carry-forward balances have been combined with the previous year's reserves and then used to acquire equipment, for example, or pay faculty conference expenses that would not have been covered by a single year's allocation.

5. Pre-audit of operations versus postaudit. As noted earlier in this monograph, many institutional representatives think that detailed procedural accountability should be replaced by accountability for results. In Kentucky, the state department of finance has replaced pre-audits with postaudits. According to an official in the state department of finance, this has allowed the department to focus more on policy issues than on routine paperwork.

More flexible management of resources is often coupled with increased accountability for the use of these resources. Kentucky's HB 622, which increases management flexibility, also requires governing boards to make annual reports to the Kentucky Council on Higher Education in a format that meets requirements of a uniform financial reporting system. Colleges and universities must also employ a qualified public accounting firm to conduct an annual financial audit to show compliance with HB 622. The secretary of finance may prescribe the minimum scope of this audit. Even though

postaudits have become more detailed, institutional representatives find the new system preferable to the old.

Increased flexibility is frequently contingent on the ability of institutions to be accountable for expenditures. In Connecticut, the House Appropriations Committee first sponsored a tuition fund bill in 1981, but concluded that, at that time, only the University of Connecticut had accounting procedures sophisticated enough to insure proper management.

Incentives and Disincentives in the State Budgetary Process

The process through which institutions receive state funding can influence institutional behavior. If funding is based on enrollment-driven formulas, for example, institutions have an incentive to increase enrollment. But if the state sets guidelines governing enrollment programs, services, or costs, there is an incentive to be concerned with factors other than enrollment.

Some states use an incremental approach to funding. Others use a detailed formula to determine funding for such areas as instruction, libraries, or capital construction. Massachusetts has switched from a budget adjusted mostly for inflation to one based on a formula. Specific parts of the formula—an enrollment factor, for example, and parity adjustments for equipment and repair—are meant to address the problems of historical inequities and insufficient accountability. Also, recently established new expenditure categories allow institutions to help determine priorities and request funding. In Florida there has been a de-emphasis on enrollment-based funding and an emphasis on program-based funding. Executive and legislative leaders want to know whether funds appropriated to specific programs are indeed used for those programs. The Florida Postsecond-

ary Education Planning Commission has been directed to coordinate the program review activities of community colleges and the university system. The use of program-based funding is being explored in Connecticut. Following a divisive battle over an incremental formula for allocations, Kentucky has recently developed a new formula that ties budget decisions more closely to institutional missions.

Restrictions on the manner in which funds are expended can also provide incentives and disincentives. In its FY 1983-85 appropriation for community colleges, the Washington legislature restricted the expenditure of state funds:

> Average basic direct instructional resources per comparable cost student shall not be less that $1,400 per academic year averaged for the biennium. Faculty full-time-equivalent entitlements for direct instructional purposes shall not be less than 3,657 FTE's per year and shall not fall below the overall student-to-faculty ratio as calculated in the governor's budget request.

This language helps define a new funding method that stresses quality through the maintenance of student-faculty ratios rather than growth as measured in full-time-equivalent students. This has eliminated, or at least severely reduced, the tendency to "do whatever is necessary" to accommodate student demands, which had results such as diluting the student-faculty ratio, reducing the percentage of full-time faculty, and reducing support services. In this regard, it should be noted that although enrollment totals were established for the community college system, the legislature was concerned that enrollment distribution among institutions be accomplished to accommodate differences in growth potential in specific areas of the state.

8

Following are descriptions of how particular states are creating incentives for effective management in higher education or removing disincentives. Sources of additional information are also listed. Readers should be aware that the applicability of particular incentives and disincentives to their institution or state depends on current state structures and financing procedures.

Appropriation Controls: Idaho

The Problem

Within a relatively short period of time, major economic changes caused a severe drain on Idaho's general funds. Budget difficulties began in November 1978 when voters approved an initiative mandating the legislature to limit property taxes to 1% of the market value of assessed property, and to limit future adjustments for inflation to 5% in any one year. The effect was to reduce significantly local support for public schools (as well as for city and county governments). Obligated by legislative mandate to maintain its level of support for public schools, the legislature elected to offset the loss of property tax support by shifting state revenues rather than by increasing them. The obvious result was that the portion of state revenues supporting public schools rose and the portion for higher education (as well as for some other state services) dropped dramatically. A major prison uprising and the eruption of Mount St. Helens entailed major cost outlays. These difficulties were compounded by the recession starting in the late 1970s which, unlike previous recessions, had major repercussions in Idaho.

During this period the state struggled to support its agencies and institutions. Appropriations fell short of inflationary growth. State revenues failed to reach even the conservative projections of the legislature, forcing the governor to hold back appropriated funds in order to maintain the balanced budget required by the state constitution. Since the governor was reluctant to hold back appropriations for public schools, other state-supported services carried the burden of Idaho's financial problems.

Impetus to Change

The decline in state support made it extremely difficult for the four public colleges and universities to continue

to provide high-quality programs and services. To help institutions respond to these severe financial conditions, the state legislature granted them greater flexibility in reallocating funds. A mechanism for implementation already existed in the form of a declaration of legislative intent and according to a staff member at the Idaho Board of Regents/Trustees, the legislature realized the difficulties of dividing up an appropriations pie that had shrunk considerably.

The Change

The major change was the switch from a line-item appropriation by number of full-time-equivalent (FTE) positions and by standard expenditures class (such as personnel services, operating expenses, and capital outlay) to a lump-sum, single appropriation to the Board of Regents/Trustees for the four public institutions. The board in turn allocated a lump sum to each institution.

Appropriations for special programs are not part of the lump sums. Programs like the Agricultural Research and Extension Services and the Washington-Alaska-Montana-Idaho (WAMI) regional medical education program continue to be funded by separate appropriations. Since moving funds between standard expenditures classes in these areas or between these areas and general education was not possible, personnel cuts in special programs were sometimes the only way of complying with budget reductions. During FY1980, for example, the personnel budget of the Agricultural Research and Extension Services Unit was cut by $290,000. Administrative staff support was reduced and farm-work staff positions were cut at several off-campus research and extension centers.

In the general education area, however, which was not subject to line-item appropriation, the university could transfer funds among units so that the burden of reductions would not fall on any single unit. For example, sup-

port for positions could be shifted to other funding sources, thus preventing (although sometimes only temporarily) personnel reductions.

The Board of Regents/Trustees also changed its practice of using the previous year's percentage as a basis for distributing funds to institutions. In an attempt to define and achieve equity among institutions, the board initiated cost and equity analyses using Information Exchange Procedures (IEP) previously developed by the National Center for Higher Education Management Systems (NCHEMS). The IEP is a set of standard definitions and procedures for gathering information (about disciplines and degree programs, outcomes of instructional programs, and general institutional characteristics) developed to facilitate information exchange and comparison. According to a board staff member, the use of cost analysis as a basis for distributing funds was premised on the theory that students at different state institutions should have equalized instructional costs if in comparable programs.

Results of the Change

Although all four public institutions in Idaho tried to make use of their new flexibility, results are perhaps most readily apparent at the University of Idaho, the state's land-grant institution. Aided by clear institutional priorities (for example, program evaluations versus personnel performance evaluations as an approach to personnel reductions), the University of Idaho tried to take maximum advantage of budgetary flexibility to:

- Respond quickly to sudden cutbacks.
- Evaluate alternatives and develop long-term approaches to financial problems.
- Reallocate resources to priority areas to preserve the institution's role and mission.

For example, the university was able to use a variety of short-term responses to mid-year budget cutbacks, including: freezing vacant positions and using salary savings as a one-time fund source; committing university operating contingency reserves to offset general account losses; and deferring expenses for capital equipment purchases, facilities maintenance, and improvement programs—again to offset general account reductions.

The university, by evaluating alternatives, was able to carry out more long-term solutions to financial problems. For example, it comprehensively reviewed major administrative procedures and business practices. These "paperflow workshops" resulted in a move toward paperless transactions, thus increasing staff productivity. The university received a NACUBO-U.S. Steel Foundation Cost Reduction Incentive Award for one of its electronic management systems.

With reallocated resources, faculty development programs retrained faculty in low-enrollment areas for programs where student demand was increasing, thus defining the priority that the university gave to academic programs. Early in planning for the first required budget cutbacks, the university president mandated a $2 reduction in nonacademic areas for each $1 reduced in academic areas.

Because flexibility was viewed as a vital response to financial stress, the university extended it to its various colleges and the departments within them. While permanent personnel positions were still controlled by the university administration, all support budget allocations (such as funds for hourly employee wages, travel, office and instructional expenses, and equipment) were distributed in a lump sum; colleges and departments, required only to submit annual budget plans, could decide how to assign their allocation. They could modify these plans during the year by moving funds from one

budget category to another via on-line transaction and without university administration review and approval.

Other institutions also have tried to take advantage of budgetary flexibility to mitigate fiscal stress. One administrator at Boise State University tells how the university decided to reduce physical plant expenditures by $75,000. To avoid being short-staffed, the university held cuts in personnel costs to only $20,000 of the $75,000. In contrast to this was a no-choice situation, when the governor mandated a four-day week for seven weeks for all state agencies. This created serious morale problems and the university would have preferred other courses of action.

Individual institutions have displayed mixed reactions to new procedures for distributing funds to institutions based on cost and equity studies. Boise State, which had grown rapidly during the 1970s, received a number of equity adjustments beginning in FY 1981. Since then, Boise had received progressive increments of $100-$200 thousand per year; the FY 1981 adjustment was $200 thousand and the FY 1984 adjustment is in the $500-$600 thousand range. But, according to a Boise administrator, such adjustments become a political problem when there is no infusion of new funds because one institution's gain is another's loss. The University of Idaho views the equity analysis itself as a disadvantage. One source observed that because the university is the state's land grant as well as major research institution, costs are higher than at other state institutions with different roles and missions, and the equity analysis may not fully consider this difference.

Summary

Having the flexibility to allocate funds internally within generally prescribed priority areas motivated the University of Idaho and other public institutions to continue

their best efforts to provide the educational programs and services essential to institutional role and mission. If, in addition to deciding how best to cope with severe financial problems, the university (as well as other institutions) had to comply with prespecified and detailed budgetary procedures, it might not have been able to preserve its long-term viability. As it was, the lump-sum appropriation method enabled it, in a somewhat limited fashion, to reallocate scarce resources effectively.

For further information:

David McKinney
Financial Vice President
University of Idaho
Moscow, Idaho 83843
208/885-6174

Jerry Wallace
Budget Director
University of Idaho
Moscow, Idaho 83843
208/885-7044

Asa M. Ruyle
Vice President for Financial Affairs and Bursar
Boise State University
1910 University Drive
Boise, Idaho 83725
208/385-1200

Ron Turner
Budget Director
Boise State University
1910 University Drive
Boise, Idaho 83725
208/385-1200

15

Stephen W. Keto
(Formerly Chief Fiscal Officer,
State Board of Education)
Administrator
Division of Support Services
Department of Health and Welfare
State Health Mail
Boise, Idaho 83720
208/334-4022

Keith Hasselquist
Budget Officer
Idaho State University
Box 8219
Pocatello, Idaho 83209
208/236-2404

Regulatory Disincentives: Kentucky

The Problem

Higher education in Kentucky was part of a highly centralized state governance structure which, in 1936, went through a comprehensive reorganization. The reorganization greatly reduced the number of governmental units and provided for a strong finance department in a "strong governor" state. It established centralized accounting and procurement functions. The 1936 reorganization was not originally intended to encompass state colleges and universities, but state appropriations to higher education institutions were kept in the state treasury, and payment documents against these appropriations were paid through a centralized accounting system. During the ensuing decades, the state institutions became more deeply mired in bureaucracy.

Centralized state procedures duplicated institutional activities and fostered the inefficient use of time and financial resources. By the mid-1970s, for example, all procurement for higher education, including capital projects, was controlled by the state department of finance. Almost all university funds, including student fees, were accounted for centrally. This centralized processing caused seemingly interminable delays, and purchased goods and services did not always yield the best value for the money. Added cost inefficiencies arose also at the campus level, where administrative units had the primary responsibility of "pushing paper" through the state bureaucracy.

Impetus to Change

Toward the end of 1980, Kentucky experienced shortfalls in state general fund receipts. The constitutional requirement for a balanced budget led to cutbacks of $44 million for higher education, which reduced the planned funding for the 1980-82 biennium from $394 million to about $350 million.

17

The election of Governor John Y. Brown in 1979 furthered the likelihood of changes in state budgetary practices. Brown, a businessman by profession, used his economic development theme of "Kentucky, the state that's run like a business" to move toward making decisions on merit rather than politics.

He commissioned an external assessment of management practices and funding levels at colleges and universities. The consultants, Price Waterhouse & Co. and MGT of America, Inc., concluded that state rules and regulations as well as bureaucratic procedures, costly for higher education, posed the biggest obstacles to sound management. The report noted that purchasing rules and regulations, for example, split purchasing activities between the state purchasing office and the institutions. Duplication also occurred in the payroll process for institutional employees and in the accounting and auditing departments. The report findings triggered bill HB 622 to separate state colleges and universities from the centralized state administrative apparatus. With unanimous support of the institutions, the "Universities Management Bill" passed in March 1982. Thus, Kentucky's public colleges were freed from most of the costly oversight of their business affairs by the department of finance and other state agencies.

The Change

The Universities Management Bill was a landmark statute; it reversed 40 years of state centralization and the steady growth of bureaucratic procedures that governed Kentucky's eight universities and thirteen community colleges. It gave institutions considerable flexibility in business management by providing for changes in purchasing, capital construction, real estate acquisition and sale, accounting and auditing, and payroll operation.

Purchasing. All purchasing is now done at the campus level, in accordance with the state's Model Procurement Code. Institutions are no longer required to purchase items from state central stores and are using their own stores more effectively. Some institutions have formed consortiums with other state institutions for cooperative purchasing, which is even more cost-effective.

Capital construction. Prior to HB 622, the state government selected and employed architects for capital projects on university campuses, and it was frequently alleged that selection criteria sometimes included factors other than professional competence. Moreover, institutions were not satisfied with the supervision exercised over contractors and consultants, who were accountable to the state department of finance rather than to the institutions. Under HB 622, state universities may now select and contract with architects and other consultants and advertise construction projects and award contracts, using the Model Procurement Code. These new procedures have substantially reduced the time between project authorization and project completion and have therefore achieved related cost savings. Management effectiveness and efficiency—that is, issues of quality and associated costs—have become primary concerns of the institutions.

Accounting and auditing. Payments are no longer made through the state government. Although certain state appropriations must be maintained centrally for investment purposes, funds are transferred daily to each institution to cover the previous day's checks. All accrual-based accounting is now done at the campus level.

HB 622 also requires colleges and universities to employ a qualified accounting firm annually to conduct a thorough audit that addresses both finances and the institution's compliance with HB 622, with the state secretary of finance prescribing the minimum scope of

such an audit. Accountability for state funds has also shifted from a pre- to postaudit, enabling the state to focus on policy issues rather than on compliance with detailed procedures.

Payroll. Under the new law, all payroll checks are written at each campus by the university treasurer, rather than by the state treasurer.

Affiliated corporations and foundations. HB 622 authorized colleges and universities to have affiliated corporations and foundations. An affiliated corporation is a corporate entity, not a public agency, over which an institution exercises control by providing substantial assistance and appointing its board of directors.

Institutional option. Institutions have the flexibility to select all or any number of the provisions of HB 622. Their selections have been based on the benefits derived from implementation and their capability to carry out the bill's provisions. To avoid the charge that this bill would cost the taxpayers more, institutions did not want responsibilities that could not be managed with existing resources (such as manpower, expertise, space, and equipment). They chose to move deliberately and to make certain that the delegated functions were managed professionally. Some institutions, such as the University of Kentucky and the University of Louisville, chose all provisions of HB 622 because they had the necessary staff to perform the newly delegated functions. Other institutions, mainly regional, chose only some of the options, declining mainly the provision for capital construction because of lack of staff (that is, planners, architects, draftspersons, and construction supervisors). Kentucky State University did not exercise any of the HB 622 options. One of the reasons was to avoid duplication of functions, such as purchasing, already performed in Frankfort, where both the Council on Higher Education and Kentucky State University are located.

Results of the Change

The effect of HB 622 on Kentucky higher education administration has been two-fold. First, the administration of higher education has become more decentralized. Accountability for institutional operations has shifted from the state department of finance to institutional governing boards. With flexibility to manage their own affairs, institutions have increased efficiency in several ways. The option of determining the best value for the money, in terms of services rendered or goods purchased, has enabled them to reduce costs for themselves and for the state. Eliminating duplicated procedures has decreased paperwork and streamlined the bureaucracy.

Further, an official in the state department of finance noted that the change from pre- to postaudit allows the department to focus on policy rather than paperwork. The department's efforts in establishing the minimum scope of the audit exemplifies how institutional and state officials can work together to insure accountability for state funds.

Second, the cooperation among the institutions during the passage of HB 622 has caused a number of legislators and state officials to reassess their views on how well institutions can manage their own operations and their willingness to work with the Kentucky Council on Higher Education to improve the management of higher education.

Institutions have assumed responsibility for insuring that the provisions of HB 622 are implemented consistently. After the bill passed, an interinstitutional committee and five subcommittees were established to: (1) gain full understanding of the bill, (2) suggest means for carrying out its provisions, and (3) identify compliance standards.

Changes in state budgetary provisions as specified by HB 622 produced immediate cost savings. For example, the standard markup on items sold in state central stores is 9%; freedom to purchase items elsewhere has enabled the University of Kentucky to save $90 thousand on estimated yearly purchases of $1 million. The university has also been able to award price contracts through its own store operations for such items as computers and chemicals at a savings of $100 thousand per year. Yearly savings of about $500 thousand are projected by the university, without any tradeoffs and in some cases with improved product quality.

The greatest savings from HB 622 have been in capital construction. When construction was handled by the department of finance, it took 15 months to select an architect, do the bidding, and award a contract. The University of Kentucky has reduced the time to seven months. From July 1982 to March 1983, the university awarded $7 million in contracts with cost savings of about $445 thousand, due primarily to shortened completion periods.

Summary

In the final analysis, the changes in Kentucky's state budgetary provisions have given the governing boards of institutions greater flexibility to manage their finances according to perceived needs and priorities. By transferring virtually full responsibility and accountability to the governing boards, Kentucky has not only increased cost effectiveness, it has considerably improved management effectiveness as well.

How valuable Kentucky's experience might be for other states depends on the degree to which higher education in these states is centralized. States with similar systems can, like Kentucky, examine the costs of

state activities that duplicate institutional functions, such as purchasing and capital construction, and possibly make a good case for decentralizing.

For further information:

Jack C. Blanton
Vice Chancellor for Administration
110 Administration Bldg.
University of Kentucky
Lexington, Kentucky 40506-0032
606/257-5701

Edward A. Carter
Associate Vice President for Planning and Budget
206 Administration Bldg.
University of Kentucky
Lexington, Kentucky 40506-0032
606/257-5701

James O. King
Vice President for Administration
102 Administration Bldg.
University of Kentucky
Lexington, Kentucky 40506-0032
606/257-1701

23

A. D. Albright
President Emeritus
Northern Kentucky University
University Drive
Highland Heights, Kentucky 41075
606/572-5100

George Ruschell
Assistant Vice Chancellor for Administration
110 Administration Bldg.
University of Kentucky
Lexington, Kentucky 40506-0032
606/257-1842

Incentives To Management Flexibility Through Deregulation: Maryland

The Problem

Until recently, public four-year institutions in the state of Maryland were subject to extensive controls by state agencies. According to a 1983 study by James Mingle, these controls were substantial, relative to other states. Maryland is a "stong governor" state, and the Department of Budget and Fiscal Planning (DBFP) is an influential controlling state agency over higher education. The governor is empowered by the constitution to direct the format and level of detail for the budget. Four-year public institutions were required to submit budget requests for both object and subobject levels of expenditure along with extensive supporting documentation. As was true for all state agencies, institutions' requests for funds over and above the Maximum Agency Request Ceiling (MARC) for state general funds, a request ceiling imposed by the governor, needed to be presented separately and stood slight chance of being approved. The MARC concerns appropriations, not expenditures, and reflects a lack of flexibility in the financing process rather than management authority.

As part of the appropriation process, institutional budget requests undergo extensive review by the DBFP, the State Board of Higher Education (SBHE), and the legislature, although the SBHE has limited authority to make recommendations and the explicit role of the General Assembly is limited to budget reduction and approval. According to the Mingle study, state-level controls also evolved from the growing competition between legislative and executive budget offices staffs. As legislative staffs expanded, they offered an analytical capability that was comparable to that of the executive budget office, and the resulting competition in turn led to increased control over state agencies, including the public four-year institutions. One state official presented a dif-

BEST COPY AVAILABLE

ferent view, saying that there was no competition between the two staffs and that DBFP was the controlling agency.

The extensive scope of required budget detail was further complicated by the fact that higher education budgets are reviewed by two state agencies that use different approaches to budgeting. For example, annual inflation allowances in DBFP budget calculations are moderated by availability of revenues, whereas corresponding recommendations determined by SBHE, which has the authority to review, consolidate, and recommend budgets, include actual standard inflation measures. SBHE recommendations reflect desirable levels of funding using established formula guidelines. The SBHE uses these formula guidelines to review budgets. The DBFP engages in line item and a more incremental review. The data requirements of the two approaches are somewhat different and, according to one official, conclusions are hard to compare and reconcile.

Appropriations for general, special, and federal funds were determined by program level at the start of the fiscal year, and all income sources, including dedicated funds, were factored in the budget. Available federal and special funds as well as private gifts were used as offsetting amounts to general funds, a practice that was a disincentive to the raising of such funds. According to a staff member of the governor's office, however, there was no evidence that donated funds had not been used for their specified purposes.

Extensive state controls went beyond budget preparation and submission into actual budget execution. To transfer funds between programs or between budgeted objects of expenditure, college and university boards needed to have budget amendments approved by DBFP. The same was true for position transfers, which required DBFP approval. State controls were further reflected in

the reversion of all unexpended and unencumbered funds at the end of the fiscal year, and in the management of investments by the state treasurer, with interest income from such funds accruing to the general treasury. State procurement laws defined further limits to expenditures for the procurement of services, commodities, supplies, construction, and information-processing equipment.

Historically, the exception to substantial controls has been the University of Maryland which had considerably greater budgetary flexibility as a result of the "University of Maryland Autonomy Act" passed in 1952. However, this statutory independence was eroded through the years and the university had limited autonomy in most matters relating to the budget process.

Impetus To Change

In 1981 and 1982, higher education officials, institutional governing boards in particular, expressed the need for broader management authority. In their view, extensive state budgetary controls over public institutions provided little incentive for rational and effective management and hampered institutional flexibility in responding to changing needs and priorities. Furthermore, having to adhere to numerous stipulations on budget preparation, submission, and implementation allowed little opportunity to focus on more important policy and program issues. Appropriate attention to these issues was necessary if Maryland's public institutions were to remain competitive with private institutions as well as with peer institutions in other states.

In arguing for change, the higher education sector maintained also that its operations are more complex than those of other state agencies and therefore require more management and budgetary flexibility. Extensive state controls, in their view, ignored governing boards'

authority and the existence of internal controls. Furthermore, such controls spawned another disincentive to good management: specific accountability for final decisions was hard to determine.

Despite these concerns about the adverse effects of overregulation, no agreement was reached on how best to restructure the financing process. However, regardless of the approach, there was consensus on the need for greater flexibility in order to improve managerial effectiveness. According to some state officials, this impetus for change was reinforced by staff changes at DBFP. There was a perception that newly appointed budget analysts were more receptive to compromise and dialogue. Others were of the opinion that the more important factor was the direction provided to staff by the secretary of budget and the governor.

In spring 1983, the governor appointed a task force to study flexibility for higher education. The 15-member panel was chaired by the Lt. governor and included state senators and delegates, members of governing boards, and the chairman of SBHE. The panel met 11 times over a 10-month period and sought input from all concerned parties, including DBFP. The panel will continue to meet until January, 1985.

The Changes

As a result of its deliberations, the task force established three goals:

1. To allow broader discretion to institutional governing boards in using budgeted funds;
2. To provide incentives for external fundraising and sponsored research, and
3. To adopt more streamlined budget submission, appropriation, and execution processes.

To fulfill these goals, the task force recommended new legislation (S.B. 960 and S.B. 957) that has recently

been signed by the governor and made effective July 1, 1984. The legislative provisions and the changes they are intended to effect are discussed below.

S.B. 960: Legislative Provisions on Budgetary Flexibility

This bill:

1. Allows the transfer of funds among objects of expenditure and programs of up to 5% of a segment's or institution's appropriated funds without submitting budget amendments for approval (budget amendments were submitted for the record).
2. Allows institutions to transfer positions among programs without prior approval by the Department of Personnel and/or DBFP, on condition that the total number of positions does not exceed the total number authorized.
3. Allows the carryover of unexpended special and federal funds from one fiscal year to the next.
4. Credits to each institution's account in the state treasury interest income derived from the institution's special funds (tuition and fees and room and board). This change will become effective during FY 1986.
5. Provides that private gifts received by institutions shall be used in accordance with donors' wishes and shall not be used as a substitute for state general funds.

Implication of S.B. 960 on the Management of Public Colleges and Universities

As a result of S.B. 960, the management of public four-year institutions can become more effective in the following ways:

BEST COPY AVAILABLE

Transfers of Funds and Positions within Specified Limits, without DBFP Approval. This change is intended to provide institutional administrators with the management flexibility to transfer financial resources and personnel to priority program areas. Previously, DBFP approval was required for all such transfers and hampered prompt redeployment of resources according to changing needs.

Carryover of Special and Federal Funds. As mentioned previously, unexpended funds, with a few exceptions, reverted to the state treasury at the end of the fiscal year. Under this arrangement, there was no incentive to build up reserve or contingency funds. As a consequence, this led to the common practice at the end of the fiscal year of spending or encumbering all such funds. To avoid reversion, some units would try to spend up to their budget limits and submitted requisitions up to the maximum allowed by the budget. As the fiscal year drew to a close, purchasing decisions often were determined by what could be obtained quickly, conveniently, and for the amount dictated by budget balancing. The ability to carry forward special and federal fund balances is intended to provide institutions with the incentive to use such funds more efficiently, for example, by making only needed and cost-effective purchases and building up reserves for contingencies or for other purposes.

Crediting Interest to the Institution. The previous practice of crediting interest income attributable to special funds (tuition and fee revenues) to the state treasury account was a disincentive to the prompt collection of tuition and fees. This change should spur institutions to collect these funds more promptly because of the prospect of added revenue that will be treated as a discretionary fund without offset of general funds.

It was also thought that allowing institutions to retain interest income on gifts and grants, which are competi-

tively solicited and won, would be an added incentive for fundraising.

Using Gifts According to Donors' Wishes. Since all sources of income were included in campus budgets, private gift and grant income could be used to offset general fund support, a disincentive to aggressive fundraising. This particular provision of S.B. 960 was included to encourage institutions in their fundraising efforts.

Treatment of Overhead Cost Recovery on Federal Grants. Another change pertains to the treatment of overhead costs related to federal grant projects. The practice at the University of Maryland was to use most of the overhead from research grants as an offset to general funds in formulating the budget. While this generated savings in general funds, it was a disincentive for researchers to compete for grants. There is a proposal to allow institutions to keep one half of funds obtained for overhead costs on federal grants for general research purposes of the institution, with the other half used to offset the state appropriation. The plan is to phase in this change. In FY 1986, institutions will be allowed to keep 25% of overhead costs. In FY 1987, they will be allowed to keep 50% of such costs. The task force has recommended that a memorandum of agreement be drawn up stating that, by FY 1987, 50% of indirect cost recoveries from grants will be budgeted for the general research purposes of institutions.

S.B. 957: Legislative Provisions on Computer Purchases

Recent legislation on institutional management is reflected also in another bill, S.B. 957. Essentially, S.B. 957 exempts computers used solely for academic and research purposes from state purchasing requirements, mainly DBFP review and approval. Previously computer

purchases had been subject to the most burdensome of procedures. For example, computer acquisition was subject to extensive prior reviews before approval, regardless of the purpose and size of purchase. It was not uncommon for the original purpose of the computer purchase (for example, to be used in support of a federal research grant) to no longer be valid by the time it was approved. Allowing institutions to purchase, without prior approval, computers that will be used solely for academic and research purposes was envisioned as an incentive for the faculty to seek research grants and thereby improve the academic standing of the institution as a whole. According to one person interviewed, this change was intended to make it easier for faculty to acquire computers in a timely fashion to support research projects. Governing boards also maintained that faculty, rather than budget analysts, were better qualified to determine their software needs.

Other Proposed Changes

Additional changes are being considered, some of which will increase even more the flexibility granted by the new provisions. This is true particularly with regard to the development and implementation of a more streamlined budget submission and appropriation process. To accomplish this objective, the task force recommended that:

> A committee cochaired by the Department of Budget and Fiscal Planning and the State Board for Higher Education, and including finance officers for each governing board and legislative fiscal analysts, be charged to determine a minimal number of budget programs for possible use in the Fiscal Year 1986 budget process.

Accordingly, a Finance Advisory Committee began meeting in January, 1984. In March, it submitted an inte-

rim report and recommendations to the Lt. governor for task force consideration. The Finance Advisory Committee has stressed the importance of consistency in budget format and objects, and the need to reduce unnecessary supporting details required from Maryland's public four-year colleges and universities. Towards this objective, the committee has made recommendations on a reduced number of budget programs, as well as on subprograms, definitions of expenditures, and supporting details. These recommendations were implemented in the FY 1986 budget submission.

The committee's recommendations are also designed to promote conformance with generally accepted accounting principles (GAAP) developed by the American Institute of Certified Public Accountants and the National Association of College and University Business Officers. One change under consideration, to provide consistency with GAAP, is the implementation of a completely campus-based appropriation that would designate X dollars as restricted funds and Y dollars as unrestricted funds, with flexibility for institutions to move funds freely within these general categories. Also under consideration by the Finance Advisory Committee are budget guidelines for the funding of four-year public colleges and universities that will be accepted by both the governor and the general assembly.

Results

It is still too early to assess the results of the changes instituted to increase flexibility and improve management effectiveness in Maryland. However, the fact that decisions were based on suggestions from all major parties concerned—governing boards of affected institutions, executive office and legislative staffs, and the State Board of Higher Education—is considered conducive to the successful implementation of the changes.

33

According to one state official, the importance of the changes, as viewed by the institutions, varies by type of institution. For example, for the University of Maryland, the state's major research university, the most important aspect of the change would be the authority to use donated funds according to donors' wishes and to revert only 50% of indirect cost recoveries on federal grants. The university has recently embarked on a major fund-raising effort as part of a plan to remain competitive with peer institutions and would stand to benefit from the freedom to use donors' funds as appropriate. Flexibility in computer purchases for academic and research purposes is also very important to the university.

To state colleges and universities, the significant changes are the authority to carry over unexpended special and federal funds from one fiscal year to the next, to transfer funds and positions, to retain the interest on special funds, and to purchase, without DBFP approval, computers used solely for academic and research purposes. The most important outcome of such changes, regardless of rank order to specific institutions, is that Maryland's colleges and universities have the added flexibility to improve management effectiveness.

For further information:

Lucie Lapovsky
Director of Finance and Facilities
Maryland State Board for Higher Education
Jeffrey Building, 16 Francis Street
Annapolis, MD 21401
301/269-2971

34

Donald Myers
Vice President for General Administration
Central Administration
University of Maryland
3300 Metzerott Road
Adelphi, MD 20783
301/853-3625

Frank Schmidtlein
(formerly Assistant to the Chancellor)
Professor, Department of Education
Policy and Administration
College of Education
Benjamin Building
University of Maryland
College Park, MD 20742
301/454-5766

Jean Spencer
Executive Director
Board of Trustees for State Universities and Colleges
16 Francis Street
Annapolis, MD 21401
301/269-3971

Sheila Tolliver
Executive Assistant for Education
Office of the Governor
State House
Annapolis, MD 21404
301/269-2377

35

Reference Documents

"Budget Flexibility Legislation Passes." *State Board for Higher Education Record*, Vol. 9, No. 2. Annapolis, Maryland: SBHE, Spring 1984.

Meisinger, Richard, Jr., and Mingle, James R., "The Extent of State Controls in Maryland Public Higher Education." James R. Mingle (Ed.), *Management Flexibility and State Regulation in Higher Education*. Atlanta, Ga.: Southern Regional Educational Board, 1983.

Administration of Local Revenues: Connecticut and Idaho

The Problem

Connecticut has extensive budgetary controls and little flexibility in financial management. In public higher education, most state appropriations lapse at the end of the fiscal year and unexpended funds revert to the state. Tuition fees, including raises and related interest, are deposited in the state treasury and included in the general fund appropriations. The number of full-time-equivalent staff funded each year is controlled by the executive branch, and the legislature is extensively involved in decisions on appropriations and budgets for higher education institutions. Funds are appropriated by line item according to major functions, and savings in one area cannot be used to offset increased costs in another area.

From the perspective of higher education institutions, the problem of extensive budgetary controls has been compounded by statewide economic difficulties. Tight state budgets and budget rescissions have occurred yearly since 1980. In Connecticut a statute on rescission allowed the governor to take away 1% to 5% of any agency's state appropriations, but in practice this applied only to appropriated funds and not to tuition revenues.

Impetus for Change

Funding reductions and extensive budgetary controls led the University of Connecticut (UConn) to push for more flexibility in financial management. UConn's major argument was that since the state, being hard pressed economically, could not give institutions additional funds, it should provide them with the flexibility to manage their own financial affairs as they could reallocate funds to meet the needs in critical areas. By having more control over its funds, the UConn administration argued, it could

better respond to fiscal stress and deal with difficulties caused by inflation and other economic problems. UConn pressed specifically for changes in policies and procedures for setting tuition and fees and managing the revenues from them.

The Change

In 1981, due to legislative initiatives sponsored by the Board of Higher Education and UConn, an experimental tuition fund was established at UConn, and the university was given authority to set its own tuition rates and to retain tuition revenues. The tuition fund was intended to facilitate both the expenditure and transfer of funds. When the fund was first proposed, other higher education institutions (technical two-year colleges, comprehensive community colleges, and the state university, with four distinct campuses) resisted the idea because of concern that tuition revenue would be used as a partial substitute for state appropriations, and thus create more problems than it would solve. Rather than seeking fiscal autonomy, the two-year colleges and the four regional state universities gave priority to improving relations with the legislative and executive branches with the hope that this would lead to more favorable consideration of requests for funds. When the bill was first sponsored in 1981, the legislature considered including all public higher education institutions in the fund; however, the House Appropriations Committee, which sponsored the bill, thought that at that time only UConn's accounting procedures were sophisticated enough to insure proper management.

UConn expected the tuition fund to: (1) provide interest income earned on tuition revenue deposits; (2) exempt tuition revenue, as nonappropriated funds, from rescissions of general fund appropriations;

(3) produce revenue gains from tuition fee raises; and
(4) give it autonomy in expending tuition fees.

Under the new arrangement, the state appropriation would be used to defray fixed costs, such as staff salaries and fringe benefits, energy costs and utility bills, and library expenses. UConn could use tuition income to pay for variable cost items (such as equipment purchases and travel).

Results of the Change

Since the tuition fund was established in 1981, the university has gained revenue from both interest income on tuition deposits and tuition fee increases, tuition revenues have not been rescinded, and UConn has managed its own tuition revenue.

Parties both inside and outside the university agree that the greatest benefit is fiscal autonomy. The university can spend tuition revenues for whatever educational purposes it considers appropriate. The only stipulation is that should actual tuition revenue exceed the budgeted tuition revenue for any particular year by more than 2%, excess revenue must be spent for student financial aid.

The student financial aid program had benefited substantially from the tuition fund. For example, in 1982 the university Board of Trustees approved tuition increases because the federal government had cut back on support for student financial aid. Sixty percent of tuition revenues during this year was used for student financial aid, increasing the pool for such funds from $750 thousand to $3.25 million. UConn is not allowed to fill vacancies without state approval. It avoided this requirement by using part of the tuition raises to fund work-study jobs for students on campus, thus providing assistance to students and insuring that necessary services were provided.

Monetary benefits that accrue to UConn from the tuition fund are not viewed similarly by all parties. Interest income from tuition revenue, for example, could be viewed as a gain in a zero-sum game: interest income to the university is interest income denied the state. Exemption of tuition revenue from rescissions has had a less clear impact. While each public agency or institution struggles to minimize the impact on its programs when budget cuts are imposed, cuts must be made somewhere. UConn's objective is to reduce the impact of such costs on the university.

Because Connecticut tuition levels have been low, state policy makers generally consider tuition increases to be justified; many state legislators are sympathetic toward tuition increases because they feel that the legislature has not been able to fund public higher education adequately.

Primary opposition to UConn's increased freedom to decide on how tuition revenues are spent comes from state auditors, who feel that such a move makes it more difficult to link state appropriations to the educational services that UConn provides. Major disagreement revolves around the degree to which the state should monitor managerial decisions on routine university operations.

However, opposition from other colleges and universities to the tuition fund has not only disappeared but has changed to support in view of the benefits from the tuition fund that have accrued to UConn since 1981. In several meetings with other institutions, UConn staff have recounted the university's experience with the tuition fund and the advantages that have been derived from increased fiscal autonomy and flexibility. As a result, during the 1984 legislative session the state legislature passed a bill granting tuition fund authority to other institutions.

40

Summary

The tuition fund at the University of Connecticut illustrates the benefits of giving institutions the flexibility to manage their financial resources, particularly when such resources are scarce. Despite dwindling state support, UConn was able to avert the harmful effects of rescissions. With autonomy to set tuition fees and to retain such funds, UConn was able to generate new revenues, allocate them to appropriate areas, and in the process continue to provide its constituents with needed programs and services.

A Note on Idaho

Like the University of Connecticut, the University of Idaho also illustrates the benefits of giving institutions flexibility in the administration of local funds. Flexibility is even more important during times of financial stress.

The University of Idaho's state appropriation includes funds from state tax revenues as well as income from student fees, land-grant endowment, and local sales and service revenues. These incomes are managed locally by the university rather than being deposited in the state treasury, as is the case for the three other public institutions. In the past, the university had communicated to its colleges and departments that any funds not expended by the end of the fiscal year would revert to the state treasury. While this is true for the state tax revenue portion of the total appropriation, the reversion does not apply to local funds.

During a recent period of financial stress, the university administration extended the "carry-forward" capability to all colleges and departments. By carefully assigning which sources of funds to use for payroll and other expenses, the university controlled unobligated sources at the end of the fiscal year and insured that all state tax

revenues were spent. Since particular sources of appropriated funds being spent were not apparent to colleges and departments, they were mainly concerned with conserving resources and getting the most out of their allocation. As a result, they significantly reduced year-end purchases, instead carrying forward small balances to compensate partially for support budget reductions. In some instances, these carry-forward balances were combined with the previous year's reserves and then used to purchase equipment or for faculty conference expenses which otherwise could not have been covered by any single year's allocation. To encourage good management of allocated support budget funds, the administration did not use these modest carry-forward reserve balances to offset loss of general account monies when the budget was cut.

For further information:

Arthur Gillis
(formerly Vice President, Finance and Administration at the University of Connecticut)
Executive Vice President for Finance and Administration
Brandeis University
Bernstein-Marcus 203
Waltham, Massachusetts 02254
617-647-2292

George Steinmetz
Staff Associate for Budget and Leases
Department of Higher Education
Board of Governors
61 Woodland Street
Hartford, Connecticut 06105
203-566-4058 or 203-566-3911

42

William Bowes
Budget Director
Department of Higher Education
Board of Governors
61 Woodland Street
Hartford, Connecticut 06105
203-566-4058 or 203-566-3911

David McKinney
Financial Vice President
University of Idaho
Moscow, Idaho 83843
208-885-6174

Jerry Wallace
Budget Director
University of Idaho
Moscow, Idaho 83843
208-885-7044

Reference Document

William Hyde. "Providing Public Colleges and Universities More Fiscal Autonomy: The Experience in Connecticut." Denver, Colorado: Education Commission of the States, June 1983.

The Budgetary Process: Massachusetts, Washington, and Kentucky

The Problem: Massachusetts

The state budgetary process in Massachusetts has traditionally been a highly political one for higher education institutions. Prior to FY 1983, each campus created its own budget and sent it to the state legislature. This process was frequently characterized by detailed bargaining over budget line items. The political nature of the budgetary process in turn led to some perceived inequities in funding among institutions. As a result, several institutions argued that their funding levels were not adequate to provide the programs and services required by their constitutents (for example, students and local industries).

Impetus to Change

In an attempt to address the problems of politically influenced budget decisions and perceived inequities and inefficiencies, the higher education sector was reorganized in FY 1981. A new governance structure, a unitary state Board of Regents, was created and empowered with a wide range of responsibilities. This new board instituted changes in both the budgetary process and the budget itself.

The Change

In a major change in the budget submission process, the Board of Regents began submitting a unitary budget request for higher education in place of individual budgets previously submitted by each campus. The unitary budget, established by legislation and fully effective in FY 1983, is based on campus budgets submitted to and incrementally adjusted by the board. Decisions on how funds will be spent within categories are made by campuses. The primary reason for the shift to a unified

budget was to depoliticize the budgetary process by minimizing, if not actually eliminating, intensive lobbying and capitalizing on political ties. In addition, the unified budget was designed as a mechanism for establishing a resource data base, not feasible under the previous process.

The basis for determining the campus budget was also changed. In place of a budget that was adjusted mainly for inflation and new programs, the board instituted a formula budget model in FY 1983. To increase accountability, the formula budget specified clear criteria, priorities, and rules for developing funding level requests.

Although the concept of the formula budget is in itself not new, attempts to correct past inefficiencies and inequities in the Massachusetts model are worth noting. Provisions focus on correcting historical inequities, the enrollment factor in funding adjustments, parity adjustments in designated budget categories, and budget priorities.

Correcting historical inequities. One flaw in the FY 1983 formula budget model perpetuated certain historical inequities caused by the roll-forward of one-time costs (such as costs for major equipment, emergency repairs, and parking lots) into the base budget of an institution. To correct this problem, the legislature and the budget subcommittee of the university president's council modified the formula in FY 1984.

In the FY 1984 formula, one-time capital costs incurred during the previous year were removed from the campus budget base. Although these particular cost inequities had existed for years, adjustments were based only on one-time costs for FY 1983, both for practical reasons and because these costs were most easily identified. Each campus was supplied with its FY 1984 adjusted base by the Board of Regents.

The enrollment factor in funding adjustments. The FY 1984 budget adjusts funding on a marginal cost basis that depends on variances from FY 1983 enrollment levels specified in the Board of Regents' budget recommendation. These enrollment levels were based on past trends, as well as on anticipated increases due to new programs or other factors such as stepped-up recruitment efforts. Funds are added or subtracted to restore the balance, depending on actual enrollment levels for the year. If the variances do not exceed 1%, no adjustments are made. The enrollment factor also helps correct historical inequities.

Parity adjustments. The FY 1984 formula budget model instituted parity adjustments for two specific accounts: (1) equipment and (2) repairs, replacements, and alterations. Minimum expenditure levels are set for these two accounts and institutions cannot reduce these levels without the board's approval. Parity adjustments are clearly intended to reduce funding variances among institutions by creating more objectively comparable maintenance bases for future formula funding.

In addition, these parity factors were established to "specifically address in a targeted fashion past historical practices that have created many of the current problems faced by institutions with an eye not only to correcting them, but also to preventing them in the future." The specific problem was deferred maintenance. One university administrator noted that prior to the unitary board and unitary budget, campus presidents often shifted funds from accounts for equipment or accounts for repairs, replacements, and alterations to accounts for salaries for permanent positions or accounts for heat and power, because they perceived these to be more critical areas for funding. Thus, equipment and facilities maintenance was often deferred. Short-term decisions like

these often led to long-term problems, as facilities deteriorated and equipment became inadequate or obsolete. Setting minimum expenditure levels helped to deal with the problem of deferred maintenance.

The establishment of budget priorities. When the unitary budget was first instituted, the Board of Regents tried to focus the budgeting process by identifying some statewide priorities. Because there was not much consultation with various campuses regarding priorities, at first the board limited its priorities to instructional programs within the context of statewide needs for skills. A staff member of the board explained that it was somewhat difficult to get funds for activities (such as plant operation and maintenance) outside the instructional program area.

In FY 1984, four new factors (categories) were added to the new instructional programs factor, to bring the number of expenditure request categories to five. The four new factors were: (1) instructional support, (2) plant, (3) information systems and data processing, and (4) management/administration systems (for example, personnel). These five factors defined both the nature and the order of FY 1984 priorities, now jointly determined by the Board of Regents and president's council. The categories reasonably cover the diverse needs of the various campuses, which have authority to identify subareas of concern within each priority area.

To encourage institutions to focus more clearly on priority areas, budget requests for these categories must be made through a **formula proposal** rather than by a formula computation. Each factor has its own standard formula proposal and operational definitions that dovetail with other budget factors. Campuses are not limited in number of requests they make in any category or in number of categories for which they request new funds.

Under the new instructional programs factor, campuses can make one request that is directly related to institutional mission.

Results of the Change

Changes in Massachusetts have produced mixed results. For instance, the unified budget does not seem to have decreased the impact of political considerations in the budgetary process. Despite submission of a unified budget by the board, budget information on each campus is still made available to the legislature. And board staff and university administrators indicated that although the state appropriation is made in a lump sum, the legislature still makes some recommendations for individual campus allocations. In general, campuses continue to lobby for their concerns.

The perception that a unified budget has not substantially decreased the political nature of the process perhaps can be better understood within certain situational considerations. The sought-after depoliticization of the budgetary process departs markedly from past practice and, like most major changes in behavior, may take more time.

On the other hand, the unified budget has eliminated detailed bargaining over line items. Basically, it is the campus that makes decisions on expenditure of funds by categories, subject to board and legislative approval. This has increased flexibility for local institutions to a certain extent, but collective bargaining agreements pertaining to personnel policies and associated costs have somewhat constrained this flexibility. Also, the governor has position control. In mid-1983, there were about 700 vacancies systemwide that could theoretically be reallocated by the Board of Regents to institutions needing additional programs. Political realities, however, pre-

vented this. The case is different for internal vacancies, which institutions can generally reassign elsewhere as appropriate.

A positive effect of the unified budget is a reasonably comprehensive data base on needed programs and services and related resource requirements, a clear aid to the state decision-making process.

Changes in budget determination, such as parity adjustments for equipment and for repairs and replacements, and removal of one-time capital costs from base budgets have restored some measure of funding equity. Institutions are now better able to focus on more critical issues such as what to change in programs and services. However, according to one administrator, a funding level that meets equity standards still may not address adequately the particular needs of an institution.

Parity adjustments (such as minimum expenditure levels for equipment and repairs) also have alleviated current problems caused by unduly deferred maintenance costs and may avert short-sighted but costly decisions in the future.

The recently established five categories for new expenditure requests have made the process of determining priorities an impetus for a more through review of programs and services. Institutions must determine which programs and services are important and relevant to perceived needs. One administrator suggests that to get requested funds, institutions should be aggressive in making their priorities known.

Finally, because the formula model allocates funds to clearly defined purposes based on agreed-upon criteria, postaudit accountability is built into the budgetary process. The formula model introduces objectivity and comparability; standards are very clear and facilitate assessment of the institution's performance in providing quality programs and services.

For further information:

Trish Kruza
Senior Budget Analyst
Board of Regents of Higher Education
One Ashburton Place, Rm. 619
Boston, Massachusetts 02108
617/727-0693

Claire Van Ummersen
Associate Vice Chancellor for Academic Affairs
Board of Regents of Higher Education
One Ashburton Place, Rm. 619
Boston, Massachusetts 02108
617/727-0610

Marie Reid
(formerly Associate Vice Chancellor for Administration and Finance and Budget Director, University of Massachusetts, Amherst)
Vice President of Budget and Finance
Atlanta University
223 Chestnut Street
Atlanta, Georgia 30308
404-681-0251

Selected Reading

Massachusetts Board of Regents of Higher Education, *Fiscal Year 1984 Budget Instructions.*

The Problem: Washington

Like a number of states, Washington's economy declined steeply in the late 1970s and early 1980s. By law, the state was required to maintain a balanced budget and consequently there was a shortage of funds for all state agencies and public institutions.

Impetus to Change

Shortage of funds impelled the legislature to change state budgetary provisions pertaining to higher education to insure that a much smaller pool of financial resources would be used more effectively. State legislators felt that higher education institutions, particularly those which had grown rapidly, were trying to do too much with too little. For example, enrollments were not being maintained at levels implied in the state appropriation. Also, public institutions were funded through a single appropriation for almost all functions and therefore had considerable flexibility to allocate funds as they deemed appropriate. Some legislators felt that funds were being moved away from some programs and functions important to educational quality.

The Change

To establish and insure educational quality standards, the Washington legislature instituted two changes:

1. In place of the previous single appropriation to higher education institutions, it allocated funds in three broad program clusters: (a) instructional programs; (b) primary support, libraries, and student services; and (c) institutional support and plant maintenance and operation. Certain funds were earmarked for specific instructional purposes. For example, for the 1983-85 biennium, for Washington's community colleges, $232.5 million were appropriated for instruction and $9.6 million for replacing and repairing instructional equipment. Institutions could move funds from program clusters "b" and "c" to "a" and between "b" and "c", however, no funds could be moved out of the instructional area.
2. Although not specified in the budget, enrollment caps were assumed in appropriation amounts. The community college system's budget for the 1983-85

biennium, based on 83,000 full-time-equivalent (FTE) students for each year, specified minimum levels for both direct instructional costs and instructional support per FTE. For example, the $232 million appropriated for instruction to the community college system are tied to the following proviso:

> Average basic direct instructional resource per comparable cost student shall not be less than $1,400 per academic year averaged for the biennium. Faculty full-time equivalent (FTE) entitlements for direct instructional purposes shall not be less than 3,657 FTE per year and shall not fall below the overall student-to-faculty ratio as calculated in the governor's budget request.

Another proviso requires the average "support instructional resources" per student to be at least $452 per year, averaged for the biennium.

The 1983-85 stipulations on enrollment caps and direct instructional cost per FTE stressed quality by maintaining student/faculty ratios rather than growth as measured in FTEs.

Although enrollment totals were established for the community college system, the legislature was concerned that distribution of the enrollments among institutions be accomplished so as to accommodate differences in growth potential in specific areas of the state. Meeting educational needs generated by growth in "high tech" industries was of particular legislative interest. Community colleges were regarded as central to the state's economic recovery in terms of providing training for jobs in high-growth businesses such as the semiconductor industry. A specific legislative provision addressed this issue:

> The state board shall review and modify its allocation method for enrollments to recognize any recent

change in student demand and needs. In determining demand and needs, the state board shall consider the needs of new industries, with special reference to the semiconductor industry, and any other state economic growth that community college education can enhance in rural as well as metropolitan areas.

Also for the 1985-85 biennium, the State Board for Community College Education received $3.5 million to fund four high-technology demonstration programs.

Understandably, institutions in geographic areas with growing populations and expanding high-technology industries would stand to benefit more from this incentive. For such institutions as Clark Community College in Vancouver, for example, funds are allocated on higher enrollment ceilings. If certain schools in the community college system do not realize their projected FTEs, unallocated funds can be redistributed to other schools experiencing growth, subject to certain agreements. Legislators linked educational programs to high-growth industry needs because they saw both student and industry demand for programs in these areas.

Results

It is perhaps too early to discern whether purposes of these fairly recent changes have been achieved. Certain observations, however, may help states that are considering similar budgetary changes.

When the new budgetary provisos were first instituted, community colleges in general felt constrained in providing access to educational programs for the particular community they served. However, because of various factors (such as demographic changes and general economic conditions), enrollments are down in many colleges. Hence, the community college system as a whole may not even reach the prescribed average FTE enroll-

ment of 83,000 for the current biennium. Under these conditions, if educational quality does improve, community colleges may view the changes not so much as having reduced access as having improved the quality of instruction and services.

When fund allocations are tied to the needs of new businesses and industries, certain institutions benefit more than others. For example, Clark Community College, located where the population is increasing and high-tech industries are expanding, would benefit. On the other hand, a small college in a rural area with a stable population base, such as Grays Harbor College, would remain basically unaffected by this change. In the long run, having public institutions serve the needs of industry would improve economic conditions in the whole state and in turn would benefit all public institutions.

Summary

The changes in Washington state are similar to those in Massachusetts in that the state is trying to influence institutional behavior by introducing certain priorities and constraints into the budgetary process. While it is too early to assess the effects of these changes, they are an attempt by the state to define and address specific institutional and state priorities.

For further information:

Harold Jacobsen
Associate Director for Financial Services
State Board for Community College Education
319 Seventh Avenue
Olympia, Washington 98504
206-753-3670

James Christiansen
Vice Chancellor of Business and Finance
Seattle Community College District
300 Elliott Avenue, West
P.O. Box C19105
Seattle, Washington 98119
206-587-4160

John Killian
Business Manager
Grays Harbor College
College Heights
Aberdeen, Washington 98520
206-532-9020

Norman Fischer
Associate Coordinator for Finance
Council for Postsecondary Education
908 East Fifth Avenue, E.W.-11
Olympia, Washington 98504-2611
206-753-3114

A Note on Kentucky

Kentucky has also revised its formula to make it more responsive to institutional and state priorities. The state's mission-driven formula funding insures that each institution is adequately funded and able to fulfill its mission, and enables the entire higher education system to serve the needs of all. In 1982, formula funding according to institutional mission, strongly endorsed by the executive branch and supported by a special citizen's committee commissioned to develop a plan for excellence in Kentucky higher education, was mandated by the legislature.

In recommending state appropriations for the current biennium (1984-86), the Council on Higher Education set the following goals:

- To enable each institution to carry out its mission as defined by the council.
- To insure program quality necessary for each institution to fulfill its mission.
- To equitably fund each institution.
- To insure access to higher education for qualified citizens who want it.

The first step in developing the formula was to identify elements in each institution's mission that can be both differentiated and measured. Then appropriate levels of support were determined for the elements. The figures were incorporated into a formula and the sum of all the individual elements yielded the calculated portion of each institution's funding needs. To these calculated amounts was added support for other programs that had been mandated by the legislation or executive branch.

The mission-driven formula in Kentucky is continuously updated and refined by review throughout the state as well as in other states with formula funding. Guidelines for developing and reviewing the formula are set by a steering committee composed of chief executive officers of the universities, the council, and the Kentucky Department of Finance. A study committee made up of budgeting and planning specialists from these same organizations develops the formula proposals. The steering committee, other state officials, private citizens, and other groups review the proposals. When the final formula is decided by the council, institutions request funds on this basis and a coordinated request is presented to the governor for subsequent appropriation by the legislature.

The mission-driven formula as implemented by the Kentucky Funding Plan offers the following advantages:

- Each institution and each activity are considered equally valuable.

- The mission-driven formula provides the best basis for equity, adequacy, and propriety in distributing state funds.
- Mission-driven formulas, grounded in activities and programs, are the simplest and most accurate method of determining the funding needed for present and projected activities.
- Applying the formula gives the council, the governor, and the general assembly a fair picture of funds that higher education *needs*—rather than what is wanted—to meet requirements of the commonwealth.
- The funding plan is flexible enough to allow for differences among missions and programs and solid enough to produce meaningful results.
- The formula allows for many variants within activities.
- The review and revision process is continual, assuring a responsiveness to changing conditions or problems uncovered during use of the formula.

Along with the development of the formula itself, policies were developed on formula use. Three fundamental principles govern formula use:

- The need for equity within the system;
- The need to protect the base budgets of the institutions; and
- The need to recognize the distinctiveness of each institution.

To fulfill the first principle, the council will recommend movement toward 100% funding of existing services for each institution as reflected in the formula. It is recognized that limited financial resources may require that this goal be realized over more than one biennium. Underlying the second principle is the recognition that progress toward 100% funding should not be achieved at the expense of damaging the approp-

riate and necessary base budgets of the institutions. Accordingly, the council intends to maintain allocations for each institution at least at the actual base level appropriation plus some continuation adjustment for each year of the recommendation. The third principle reflects the fact that each institution has needs that are not specifically addressed in the formulas. Therefore, each institution will have an opportunity to make additional funding requests to address these needs, subject to review and approval by the council, and to review and recommendation by the Financial Affairs Committee.

Kentucky had used formula funding in a limited manner for several years prior to its formal implementation in 1982. In a more substantial use of the formula during the 1982-84 biennium, a number of issues and concerns were raised, which were subsequently addressed in the 1984-86 appropriation recommendation. The issues were identified from the comments of the presidents of institutions, the testimonies at public hearings, and comments of council members. Following are the issues and responses:

- The first issue was that use of a formula for funding higher education was not required. This was resolved by Senate Bill 168 and council actions which have mandated that a formula be developed. The statutes do not require the formula to be used by the council, the governor, nor the legislature; however, the statutes do require the existence of a formula.
- Another issue was the question of inadequate institutional involvement in formula development. The formula review process, now completed, included extensive institutional involvement.
- The most significant advancement in the revised formula occurred on the issue of common support

for common activities in instruction, research, and public service. This was the major issue in the 1982-84 formula. The 1984-86 formula generates common support for common activities.

- The use of a three-year average enrollment in the revised formula addresses the institutions' concerns that the formula did not respond to enrollment fluctuations. Summer school enrollment has also been added to formula calculations.
- The 1982-84 formula was heavily criticized because many programs were omitted from formula calculations. The revised formula includes these programs—for example, medical, dental, and cooperative extension—as formula calculated items.
- There is now a rationale for the formula components and rates derived from the review of the formulas of other states, the review of activities in Kentucky institutions, and the combined efforts of institutional and council staff.

Reference Documents

Mission-Driven Formula Funding: The Kentucky Plan.
1984/86 Budget Request Guidelines.
1984/86 Appropriation Recommendation Formula.

All published by the Kentucky Council on Higher Education, West Frankfort Office Complex, 1050 U.S. 127 South, Frankfort, KY 40601. 502/564-3576

NACUBO Board of Directors

Fred S. Vorsanger, President, *University of Arkansas System*
Joe F. Evans, Vice President/President Elect, *Washington University*
Raymond M. Krehel, Secretary, *Colgate University*
R.R. Reid, Treasurer, *Whitman College*
Charlotte V. Berry, *California State University-Long Beach*
Mary B. Breslin, BVM, *Mundelein College*
George Davis, Jr., *Montgomery College*
William L. Erickson, *San Diego State University*
Roger J. Fecher, *Kalamazoo College*
Judith Cooper Guido, *Union Theological Seminary*
Caspa L. Harris, Jr., *Howard University*
Ken J. Kolbert, *College of DuPage*
Carroll J. Lee, *University of New Mexico*
Louis Moelchert, Jr., *University of Richmond*
John D. Mulholland, *Indiana University*
George J. Ruschell, *University of Kentucky*
W.T. Shropshire, *Huston-Tillotson College*
John L. Temple, *Emory University*
Alvin N. Ward, *Drexel University*

Robert L. Carr, *Executive Vice President*